Testimony of Thomas F. Ryan, Jr.
President and Chief Operating Officer
American Stock Exchange, Inc.

Before the
Subcommittee on Finance and Hazardous Materials
Committee on Commerce
U.S. House of Representatives

on
H.R. 1053
The Common Cents Stock Pricing Act of 1997

April 16, 1997

AMEX

Summary of Testimony of
Thomas F. Ryan, Jr., American Stock Exchange, Inc.
House Subcommittee on Finance and Hazardous Materials
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The AMEX has demonstrated a strong commitment to moving to narrower price intervals for AMEX equity securities. Based on our experience in trading in fractions of 1/16 instead of 1/8 of a dollar for many of our securities, we have determined to reduce the minimum trading increment to a sixteenth for *all* our equity securities, and hope to implement this change later this month, pending SEC approval. This will reduce the minimum trading increment by one-half, no small change. Our initiative represents a continuation of a process we began in 1992, when we narrowed the minimum trading fraction from 1/8 to 1/16 of a dollar for stocks priced below $5; and which we continued in 1995, when we expanded the number of stocks eligible for sixteenths trading to include stocks priced under $10.

AMEX took these steps without a congressional or SEC mandate. We continue to view rationally smaller trading increments as good for investors and good for business by promoting intermarket price competition. The operational and systems costs incurred by AMEX members, other exchange members, and the securities industry at large to accommodate sixteenths trading in AMEX securities have been and are expected to be minimal in terms of required systems enhancements. This will not be true for a conversion to decimals, and the Subcommittee should obtain realistic estimates of industry-wide costs to convert, and assess whether the need to deal concurrently with the "Year 2000" computer problem might not exponentially increase the difficulty involved in a conversion to decimals.

We believe the impetus toward finer trading increments will continue, and we agree that decimal trading is eventually inevitable. While we do not believe legislation is necessary at this time, as long as the cost of conversion is modest, and experts assure us that the project can be managed coincident with dealing with the millennium problem, we see no adverse market structure implications from moving to decimals with a minimum increment of five cents.

We would object to a government mandate to move to a *radically* narrower minimum increment, whether that is a penny or one-sixty-fourth. Where the balance point is that maximizes public order liquidity while allowing an appropriate amount of price competition is a question of judgment. It is a judgment that has traditionally been made by the primary market, and should not be left to electronic communications networks, for example, to determine.

The AMEX will be carefully assessing the impact of expanded sixteenths trading in its own market, and we are committed to serving the needs of our investors. If those needs include a conversion to decimal pricing and that conversion is deemed cost-effective by the industry after careful cost/benefit analysis, we will readily make such a move. Our record attests to our responsiveness and leadership in this area and we remain committed to maximizing potential benefits to public investors and to our member firms.

My name is Thomas F. Ryan, Jr., and I am President of the American Stock Exchange. It is my pleasure to have this opportunity to present the views of the AMEX on H.R. 1053, the Common Cents Stock Pricing Act of 1997. We commend Chairman Oxley and Representative Markey for bringing to the forefront the issue of whether changes to current trading increments for stocks are required to best meet the needs of the investing public and of our securities markets.

The AMEX has demonstrated a strong commitment to moving to narrower price intervals for AMEX equity securities. Based on our experience in trading in fractions of 1/16 instead of 1/8 of a dollar for many of our securities, we favor reducing the minimum trading increment to a sixteenth for all our equity securities. Indeed, we have submitted the necessary rule change to the SEC and hope to implement trading in sixteenths for all AMEX stocks later this month, pending SEC approval. It should be borne in mind that this change will reduce the minimum trading increment by one-half. This is no small change.

This initiative represents a continuation of a process we began in 1992, when we narrowed the minimum trading fraction from 1/8 to 1116 of a dollar for stocks priced below $5; and which we continued in 1995, when we significantly expanded the number of stocks eligible for sixteenths trading to include stocks priced under $10. It is possible the Exchange in the future will even further narrow the trading increment for at least some of our listed securities. In fact, one of AMEX's most actively traded securities - Standard & Poor's Depositary Receipts@ - trades in fractions of 1/64, which we believe is an optimal trading increment given the specific trading characteristics of that security. However, at present, as a general proposition a minimum trading increment of one-sixteenth in AMEX-listed securities represents a compromise between the preservation of liquidity in our market and the opportunity for having more pricing points that can result in reduced spreads for our investors. We believe that a sixteenth increment for all our stocks is the optimal minimum interval at this time. Deviations from this standard for specific securities would be evaluated by the AMEX in regard to the specific characteristics of the subject security.

Two important points should be made here. First, AMEX took these steps without a congressional or SEC mandate. Our initial move to sixteenths was well before the SEC, in its 1994 *Market* 2000 *Study*, recommended that the markets implement a sixteenth trading increment as soon as possible. We continue to view rationally smaller trading increments as good for investors and good for business by promoting intermarket price competition. Second, the operational and systems costs incurred by AMEX members, other exchange members, and the securities industry at large to accommodate sixteenths trading in AMEX securities have been and are expected to be minimal in terms of required systems enhancements. Systems are already designed to easily accommodate fractional increments, even narrower than eighths and sixteenths, since industry participants have for many years traded various specific products in very small fractions. That would not be the case with respect to decimals. We are unaware of any currently available inclusive estimates of the costs to exchanges, broker-dealers and other industry participants of systems conversions to accommodate trading in decimals, and we encourage the Subcommittee to obtain realistic estimates from the firms and other system participants who will in fact have to implement such a conversion. In view of the need to also deal with the “millennium” or “Year 2000” problem in all our computer systems, we also urge the Subcommittee to carefully evaluate whether a requirement to program, test and implement several significant systems changes at once does not exponentially increase the difficulty over what would be involved in tackling the issues one at a time.

We believe the impetus toward finer trading increments will continue and will grow. We note that AMEX’s sixteenths initiative opens up sixteenths trading in all markets in which AMEX equity securities are traded, including the regional exchanges and the third market. The Intermarket Trading System (ITS), which provides a means for U.S. securities marketplaces to route orders among one another, is currently being modified to allow all markets to send commitments to trade in sixteenths through ITS in

AMEX stocks, and all markets will be able to disseminate quotations in sixteenths for AMEX securities. This will provide for an enhanced level of intermarket pricing competition that will benefit investors by potentially lowering transaction costs in all markets for AMEX stocks.

Other markets are also moving on their own accord to narrower increments. The Nasdaq Stock Market has recently approved a minimum quotation increment of 1/16 for their stocks over $10, and we commend them for that effort. It seems clear that the U.S. securities industry is evolving towards narrower trading increments, and that this evolution will continue. We also agree with the SEC's observation in its *Market 2000 Study,* as well as with other market observers, that decimal trading is probably inevitable. Indeed, if the proposition were that we should trade in decimals with a nickel as the minimum increment, as is largely the case in Canada, we would be happy to go along. We do not understand why legislation is necessary at this time, but as long as the cost of conversion is modest, and experts assure us that the project can be managed coincident with dealing with the millennium problem, we see no adverse market structure implications. We view minimum increments of a sixteenth or a nickel as functionally the same.

What we object to is a government mandate to move to a *radically* narrower minimum increment, whether that is a penny or one-sixty-fourth. Commissioner Wallman testified before this Subcommittee on April 10 that the government would not mandate the increment at which a marketplace may trade and that each exchange could continue to set the increment at which trades on its market could occur. But he also believes that electronic communications networks ("ECNs") must be given access to each market and that the interaction must occur at whatever narrow increment the ECN proposes to use. As a practical matter, this gives control of the increment to each ECN, since no market can restrict dealing on its own floor to sixteenths or nickels, for example, when brokers everywhere, including on its floor, are free, and perhaps even legally obligated, to deal off that floor in sixty-fourths or pennies.

I would like to remind the Subcommittee that organized securities trading started off in this country as an auction, and on the exchanges today it is still an auction -- a continuous auction, but an auction nonetheless. It is quite common at any auction for the auction house to have rules about the bidding increments. No one expects to be outbid by a penny for a Rembrandt. Even at the "country auctions" you find regularly held in small towns in America, there are bidding increments. No one expects to be outbid by a penny for Uncle Floyd's accordion, either. These are methods for ordering a process, and in the exchange auction markets minimum increments are a way to aggregate interest around a finite set of prices, to maximize the opportunity for investors to agree on a price and deal directly with each other, rather than through a dealer. Where the balance point is that maximizes public order liquidity while allowing an appropriate amount of price competition is a question of judgment. It is a judgment that has traditionally been made by the primary market that has listed the security and whose market makers have the responsibility for the maintenance of an orderly market in the security. It does not appear to us to be the kind of decision that should be left *de facto* to an ECN with only its own interest at heart.

AMEX's experience in sixteenths trading, as well as the Toronto Stock Exchange's ("TSE") 1996 conversion to decimal pricing with a nickel increment, have provided the academic community with an opportunity to review the market impact of smaller fractional and decimal increments, including the impact on spreads and transaction costs. Studies indicate that spreads between bids and offers on both AMEX and TSE have been reduced with resulting lower transaction costs for investors. But we note that the results of these studies may not necessarily be applicable to higher priced, more actively traded securities. Furthermore, the time periods under study were limited essentially to "bull" markets. The upcoming commencement of sixteenths trading in AMEX stocks priced above $10, which include some our most actively traded issues, as well as Nasdaq's move to sixteenth quoting in similarly priced stocks, will provide market observers with an additional, more complete, opportunity to assess the market impact of trading in narrower increments. This information should be helpful in allowing the securities markets to develop trading increments that serve investors best while maintaining market efficiency and liquidity.

The AMEX will be carefully assessing the impact of expanded sixteenths trading in its own market. The AMEX is committed to serving the needs of our investors. If those needs include a conversion to decimal pricing and that conversion is deemed cost-effective by the industry after careful cost/benefit analysis, we will readily make such a move.

Our record attests to our responsiveness and leadership in this area and we remain committed to maximizing potential benefits to public investors and to our member firms. The AMEX welcomes this opportunity to present our views on this important issue and is ready and willing to assist the Committee as it proceeds with its deliberations.

Thomas F. Ryan, Jr.
President and Chief Operating Officer
American Stock Exchange, Inc.

Thomas F. Ryan, Jr. became President and Chief Operating Officer of the American Stock Exchange on October 15, 1995 following 27 years with Ridder, Peabody & Co., Inc., the investment bank and broker-dealer.

Mr. Ryan was named chairman of the board and chief executive officer of Kidder, Peabody Group, Inc. in January 1995 after having served as executive managing director in charge of the Equity Group of Kidder Peabody since 1987. From October 1994 until January 1995, Mr. Ryan was co-chairman of the Ridder Peabody/Paine Webber transition committee.

Having joined Ridder Peabody in August 1968 in Boston, Mr. Ryan transferred to the New York headquarters in 1970, was named head of block trading in 1976 and head of equity trading in 1985. Mr. Ryan was elected to the board of directors in 1983 and to the management and executive committees in 1988. Prior to joining Ridder Peabody, Mr. Ryan was vice president of business development for the Boston Stock Exchange from 1966 to 1968.

Mr. Ryan was a member of the Market Performance Committee of the New York Stock Exchange and a member and chairman of the Traders Advisory Committee to the Chairman of the New York Stock Exchange. He served as a member of the, Securities and Exchange Commission Intermarket Trading Committee in 1982 and as co-chairman of the NYSE Market Regulation Review Committee from 1986 to 1988.

Mr. Ryan graduated from Boston College in 1963 with a B.S./B.A. degree. He is a graduate of the Boston Latin School. Born on July 26, 1941 in Boston, Massachusetts, Mr. Ryan is married and has two children.